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DIRECTORATE OF
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Intelligence Memorandum

Czechoslovakia's Search For An Economic Miracle

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1970

INTELLIGENCE MEMORANDUM

Czechoslovakia's Search For An Economic Miracle

Introduction

In working out Czechoslovakia's five-year plan for 1971-75, the Husak regime has adopted a general approach that fits the regime's political strategy of tight domestic controls and close relations with the USSR. Present proposals for the plan -- scheduled for unveiling in final form early in 1971 -- involve a heavy reliance on traditional economic policies. The main departures, already foreshadowed by changes in recent years, are shifts in investment priorities and consumption patterns. This memorandum analyzes the implications of these policies -- how they are interrelated and what the chances are of success.

The Growth Policy of the Husak Regime

1. As an alternative to the economic goals of the 1968 reformers, the Husak regime in planning for the 1970s is following the main outlines of Novotny's economic policies. The regime has turned away from the reformers' emphasis on light industry and their hope for large-scale Western help. Instead, the regime is basing its hopes for economic development on the traditional growth sectors in heavy industry. It is not counting on foreign aid, and it is relying heavily on increased trade, especially in machinery, with the USSR and the rest of Eastern Europe.

2. Yet the Husak regime has kept the reformers' plan for radical changes in the priorities for

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investment -- major increases in investment in agriculture, the construction industry, transportation, and housing rather than in industry -- and for large increases in consumer durables. Investment in industry is to increase very slowly. The reformers argued that larger gains in efficiency and output would come from investing in areas other than heavy industry and that the time had come to meet consumers' long-deferred expectations for more housing and durables. These arguments, it appears, are still accepted.

3. The service sectors are also expected to get most of the 1½% to 2% annual increase in nonagricultural employment, as agricultural employment continues to decline. Industry as a whole must maintain the growth of output not only with a slower increase in investment but also with little increase in employment. In short, the Husak regime is falling back on the hope of tapping "hidden reserves." Without much increase in investment or in overall employment, as V. Hula, chairman of the Economic Council, has admitted: "Practically the only source of growth for national income in the fifth five-year plan (1971-75) will be the growth of social labor productivity."

The Growth of Labor Productivity in Industry

4. In order to achieve an industrial growth rate averaging 5% to 6% annually during 1971-75 -- with production of machinery increasing at 8% annually -- the Husak regime is relying on comparable increases in labor productivity. The projected increase is to come mainly from improved worker discipline and major shifts in employment from branches with poor growth prospects to the most promising branches. The large increases in production of machinery will be allocated for export and for investment in nonindustrial sectors of the economy, while modernization and expansion of industrial enterprises is severely curtailed. Faced with a tight labor supply (one estimate puts the present "shortage" at 100,000 workers), planners intend to permit investment in new industrial projects only in cases where the necessary labor can clearly be made available.

5. The regime is undertaking, first, to improve management in hopes of overcoming slack worker discipline, estimated to result in an average 20% to 30% loss of working time. P. Tomasek, Deputy Minister of Labor and Social Affairs, has observed that if

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each of the 7 million Czech and Slovak workers increased his productive labor time by ten minutes a day, the result would be equivalent to an increase of 146,000 workers.

6. Although four weekend days spread throughout the year were recently eliminated as days off, plans do not, as yet, call for the lengthening of the regular five-day workweek to pre-1968 levels. Instead, the leadership is undertaking to increase the use of existing capacity in key enterprises and branches by substantially increasing the numbers of workers on second and third shifts. Improving the rate of shift work, now the lowest among Communist countries, will require the mandatory and voluntary movement of workers to favored branches of industry. For this purpose, not only will employment counseling services be established to make job information available, but also workers suspected of idling on the job may be arbitrarily transferred to an enterprise where additional shifts are being formed.

7. The obstacles to achieving these hopes are formidable. It will be a major task to win the cooperation of the demoralized Czechoslovak labor force in increasing production. Weak managers appointed long since for political reasons still run most plants, and political qualifications are again a key factor in new appointments. The hostility between the workers and the purged Party apparatus at the local level is not likely to die out in the near future. Attempts to move workers to new jobs and, even more, to other plants and evening and night shifts will add to the problem.

Consumption and Investment Priorities

8. The extent of actual gains achieved in productivity will determine the increase of consumption and investment. The most rapid increase planned in consumption is in consumer durables. For 1971-75, Czechoslovak planners are proposing a 14% annual increase in the supply of consumer durables, thereby maintaining the similarly high 17% annual increase of 1965-68. As a result, stocks of major durables are planned to increase as follows:

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	<u>Number per 100 Households</u>	<u>Average Annual Percentage Increase</u>	
	<u>1965</u>	<u>Plan 1975</u>	
Washing machines	64	75	1.6
Refrigerators	33	90	10.6
Television sets	55	90	5.0
Radios	97	117	1.9
Passenger cars	9	30	12.8

9. If demand for consumer durables remains as strong as expected -- obviously this will depend a good deal on the quality and mix of the goods supplied -- consumption patterns will be considerably changed and inflationary pressures in the economy will be reduced. Larger purchases of durables should ease demand for meat, particularly pork, which has become a substitute luxury good, and probably for most textiles, clothing, and footwear. According to projection by the planners, the increase in purchases of consumer durables is expected to outstrip the rate of increase for soft goods by two or three times by 1975, and purchases of durables will rise to 35% of purchases of all nonfood items.

10. The policy of giving the people what they want most -- and consumer durables are at the top of the list -- is not only good politics but also good business for the regime. Prices of durables are much higher relative to prices of soft goods and foodstuffs than in Western countries, and for some years the regime will be able to maintain such prices, although increased use will have to be made of consumer credit. The attempt to catch up with the West European standard for foods and soft goods has been very costly and inefficient.

11. To ease the other area of critical shortage -- housing -- Czechoslovak planners are committed to

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begin at least the expansion of housing construction during 1971-75. The supply of housing has barely increased in the last 20 years, and there are acute shortages in the cities. If the construction sector receives the proposed 100% increase in machinery investments over the previous five-year period, housing construction should be speeded up (although the increase is also intended to reduce the long construction times in all sectors and to lower the stock of unfinished construction). The planners hope to attain an annual construction rate of 110,000 new dwellings (approximately the target proposed for 1969 but underfilled by about 20,000 dwellings), sufficient to increase the housing supply slightly faster than the population. In order to do so, the construction industry will probably turn increasingly to the use of prefabricated structures, in which Czechoslovakia has lagged behind other Communist countries. Construction of new plants producing prefabricated units is currently being expanded. In addition, the USSR has promised to deliver four plants in 1970 for the manufacture of sufficient prefabricated panels for 12,000 apartments, and nine similar plants -- smaller in capacity -- are to be imported from the West. (At the same time, however, the agreement by which Yugoslavia was to build 13,000 apartments for the Czechoslovaks by 1974 has apparently been suspended.) Housing construction will also be helped by plans for increasing production of building materials by 90% during 1971-75 and for restricting new construction starts in industry.

12. While expanding investment in housing and in the other problem areas of agriculture and transportation, the regime is drastically limiting investment in industry. Not only will construction of new industrial facilities be severely restricted, but new machinery investments in industry also will be allowed to increase only 18% in the five-year period, approximately 3½% annually. Of this meager increase, 25% will be designated for projects already under way, another 25% will be allocated to enterprises for small-scale improvements at their discretion, and 30% will be invested in new capacity in the fuel and power industries. Only 20% of the severely curtailed investment funds for industry will therefore be available for new projects in other branches, including consumer goods. As a result of determining the limited availability of investment funds, planners have been forced to cut back the expansion plans of even high-priority industries, such

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as the automobile industry. Part of the investment originally proposed in the automobile industry for 1971-75 will now be spread out through the second half of the decade, perhaps endangering the long-term goal for an increase in production capacity to 300,000 cars annually by 1980 (up from 134,400 in 1969).

13. Machinery investments in and for agriculture and the food industries, however, will increase 40% during 1971-75, with particular attention to expanding food-processing facilities, fertilizer plants, and grain silos and warehouses as well as to constructing additional facilities for large-scale production of eggs and meat. Machinery investments in the services sector will increase 35% in the five-year period, with the major proportion going to transportation. Railroad transportation service, the source of chronic supply bottlenecks, will be upgraded, with plans calling for increased electrification of lines, better facilities for repair of railroad cars, and additional capacity at reloading stations at the Soviet border. Truck transportation will also be expanded and new roads constructed.

Machinery Production and Trade Implications

14. Instead of diversifying domestic production in order to fulfill new machinery demands, Czechoslovak planners, as far as possible, are calling for increased international specialization of production. Czechoslovakia proposes to concentrate on machinery items for which production advantages have already been proved; the planners thereby hope to begin overcoming the inefficiencies inherited from the 1950s, when too wide a range of products in the machinery branches was developed. Czechoslovakia will continue to depend increasingly on trade with other Communist countries for investment goods and consumer durables. While total domestic demand for machinery and equipment is expected to increase by 4% to 5% annually during 1971-75, machinery imports will increase at close to double that rate.

15. To expand trade in machinery, Czechoslovakia must work out detailed plans with the USSR -- its major customer and supplier -- and the other East European countries. In the absence of large long-term credits, Czechoslovakia will not rely heavily

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on Western machinery, and sales of machinery to the West will still remain a small share of total exports, although there are prospects for expansion of machinery exports to the less developed countries. In a recent statement, Z. Sedevy, Deputy Federal Minister of Planning, recognized Czechoslovakia's necessarily closer ties with the Communist world as a result of its development objectives:

The creation of these external conditions (of international production specialization) for the long-term development of the economy is easiest for socialist Czechoslovakia within the economic community of socialist countries. Only within this community is it possible to build up the economic basis of a mature socialist society in a planned manner In the coordination of plans (with other Communist countries) for the period 1971-75 and in binding discussions on long-term agreement a more speedy exchange of goods must be developed

16. The Soviet leadership is willing to cooperate with Czechoslovakia in increasing trade in machinery so long as it is mutually advantageous -- that is, so long as most of the increase in Soviet imports of machinery is balanced by Soviet exports of machinery to Czechoslovakia. This type of bilateral Soviet cooperation indeed forms the basis of the closer coordination of plans that the USSR has been urging in CEMA as the way to push specialization in production in all East European countries. Although trade with the USSR is not expected to rise much above its present share of about one-third of all of Czechoslovakia's trade, deliveries of Soviet machinery and equipment -- including consumer durables in 1970 at least -- are expected to increase at a faster rate than the proposed 5½% to 6½% annual increases in total Czechoslovak-Soviet trade. In return, Czechoslovakia must export increased amounts not only of its traditional machinery exports (including metalworking machine tools, equipment for chemical and petrochemical plants, streetcars, locomotives, freight cars, and trucks) but also more consumer durables. In the next few years, the USSR will undoubtedly increase the share of machinery in

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its total imports from Czechoslovakia above the level of 58% for 1968. However, how much the share will increase is still to be negotiated.

17. The problems in the coordination of plans with the USSR and other CEMA members remain formidable -- no less so than the obstacles to Czechoslovakia's domestic production goals. Since other East European countries tend to specialize in many of the same machinery items as Czechoslovakia, bargaining with them about machinery production and trade appears almost hopeless to many East European economists (although some willingness to cooperate has been indicated in such fields as computer technology and in the chemical and automobile industries). For its part, the USSR has repeatedly indicated its unwillingness to accept as large a share of machinery in its imports as proposed by Czechoslovakia. The Czechs would like to deliver machinery to pay for most of the additional industrial materials promised by the USSR, but the Soviet government does not agree. In return for accommodating the Czechoslovaks in 1970 with increased deliveries of Soviet-made consumer durables and decreased imports of Czechoslovak-made durables, the USSR is pushing for large imports of consumer nondurable goods from Czechoslovakia during 1971-75. How successfully the Czechs can evade these demands will considerably affect the success of their development program.

Conclusions

18. Czechoslovakia's economic planning for 1971-75 is based on the political realities imposed by the Husak regime -- tight central control over the economy and close economic relations with the USSR and Eastern Europe. The planners have had to abandon the proposal, urged by the reformers of 1968, to revive Czech light industry (under decentralized management) and to seek closer economic relations with the West. Inevitably they have reverted to the policies followed under Novotny, which rely on expanding the heavy industries developed under Communist rule, especially the machinery and equipment industries, and on the expansion of trade with the Communist world.

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19. Under these policies, industrial output is expected to rise in the early 1970s at a rate of about 6% -- 8% in key heavy industries, including the engineering industries -- with little new capacity and practically no increase in employment.

20. Along with continued emphasis on machinery production, the regime is hoping for closer cooperation with the USSR and other East European countries in planning production and trade. Czechoslovakia is pushing increased specialization of production among CEMA members as a means not only to expand exports of certain machinery lines but also to increase imports of the new machinery mix required for the proposed investment program. The regime proposes to change the composition of machinery used domestically in order to concentrate investment in more or less neglected sectors of the economy and to boost sales of consumer durables. Large increases are under consideration in investment in food production, in the construction industry and housing, and in transportation.

21. Changes of this kind will come much more slowly than presently projected. They depend on the degree of success achieved in tightening labor discipline, improving management, and increasing economic collaboration with the other Communist countries. Given the slackness of the labor force, the poor quality of management, and the demoralization of workers and management alike since August 1968, it would require a miracle to achieve rapid growth in productivity. Cooperation with the USSR and other East European countries, as experience has shown, improves very slowly in the face of institutional rigidities and conflicts in interest. Thus the economic development of Czechoslovakia in the early 1970s is likely to be disappointing to the leadership, the elite, and the population alike, and to put additional strains on the unpopular Husak regime.

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